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INFO RUEHAC/AMEMBASSY ASUNCION 0869
RUEHBU/AMEMBASSY BUENOS AIRES 1665
RUEHBO/AMEMBASSY BOGOTA 7477
RUEHLP/AMEMBASSY LA PAZ AUG LIMA 0848
RUEHMN/AMEMBASSY MONTEVIDEO 0904
RUEHQT/AMEMBASSY QUITO 2665
RUEHSG/AMEMBASSY SANTIAGO 3991
RUEHSO/AMCONSUL SAO PAULO 0078
RHEBAAA/DEPT OF ENERGY
RUCPDOC/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
RHEHNSC/NSC WASHDC
RUMIAAA/HQ USSOUTHCOM MIAMI FL

C O N F I D E N T I A L CARACAS 001679

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR MMALLOY AND KAUSTIN
COMMERCE FOR 4431/MAC/WH/MCAMERON
ENERGY FOR ALOCKWOOD AND CDAY
NSC FOR JCARDENAS
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: DECL: 08/23/2017
TAGS: ECON EFIN VE
SUBJECT: BRV'S DIRECTOR OF PUBLIC CREDIT -- A SMOOTH
OPERATOR

REF: A. CARACAS 741

¶B. CARACAS 869
¶C. CARACAS 1292
¶D. CARACAS 1638

Classified By: Economic Counselor Andrew N. Bowen for reasons 1.4(b) an
d (d).

¶1. (C) SUMMARY: Econoffs met with the Director of Public Credit, Luis Davila on August 21. During a frank discussion of the BRV's financial policies and activities in the capital markets, Davila painted a rosy picture. The BRV did not expect to issue any foreign debt this year and debt should shrink as a percentage of GDP. He said the recent "bono del sur 3" postponement was the result of global capital market turbulence, and the April PDVSA USD 7.5 billion mega-bond issue had demonstrated a lack of BRV coordination. He added that the BRV intended to institute a mechanism to intervene in the parallel market to reduce the parallel rate for dollars, and that the large amount of risky structured notes purchased by FONDEN in 2006 was the poor outcome of good intentions to reduce Venezuela's risk rating. He noted the BRV had approximately USD 65 billion in liquid, hard-currency assets, and had no intention of withdrawing from the IMF in the near future. END SUMMARY.

¶2. (C) On August 21 EconCouns and Econoff met with the Director of Public Credit at the Ministry of People's Power for finance (MPPF), Luis Davila. According to Davila, the BRV's financial situation is healthy and the BRV does not have additional financing needs this year. However, the budget bill passed in 2006 (based on a USD 29/barrel price of oil) assumed that the BRV would run a Bs. 9 trillion (USD 4.2 billion at the official exchange rate) deficit and thus authorized the MPPF to issue debt for this amount. Under Venezuelan law, the MPPF now has to issue debt this year even though the government "does not need the money."

¶3. (C) There are no foreign currency denominated issuances planned and Venezuela's foreign debt load is around USD 26 billion (approximately 13 pct of GDP; but rises to 19 pct when PDVSA's USD 12 billion of debt is included). This level should remain constant, though as percentage of GDP, foreign debt will continue to fall as the economy grows. The BRV has preferred to issue debt locally in recent years, which Davila attributes to local markets' capacity to absorb these issuances.

¶4. (C) The MPPF decided to postpone the third "bono del sur" on August 16 due to the instability in international markets (reftel D). Davila noted that the Argentine BODEN 15s that would have been issued fell in value from 82 percent of face value on the day the issuance was announced to 75 on the day it was canceled. The decision to sell USD 1 billion worth of bolivar-denominated, devaluation protected Venezuelan TICC bonds and only USD 500 million of Argentine BODENs (which are dollar-denominated and drive demand for the package) was intended to push the implicit cost of the dollars closer to the parallel market rate by forcing investors to buy more bolivar-denominated notes.

¶5. (C) Davila described the process leading up to the massive USD 7.5 billion PVDSA bond issuance in April 2007 (reftel A) as one defined by an unfortunate lack of coordination between the various BRV agencies and PDVSA. He admitted that the

Ministry was not consulted about the decision to increase the amount (from an original USD 3.5 billion) and hinted that had he been consulted, he would have advised against the increase. He noted that the precipitous drop in the value of these bonds and the sheer amount of bonds trading in

international markets means that PDVSA will have trouble issuing more debt in the future.

¶6. (C) Turning to the matter of the large amount of structured notes the National Development Fund (FONDEN) had purchased in 2006, Davila said that the BRV purchased these notes to lower the cost of Venezuelan Credit Default Swaps (CDSs) and thus the country's risk premium. Davila admitted that they had been a bad investment as the value of the notes had fallen, mostly due to market concerns that Ecuador would default on its obligations. He claimed that FONDEN needed to unwind these commitments in order to continue its mission funding projects, but that it wouldn't be easy as these instruments were complex. (Note: FONDEN reportedly purchased approximately USD 6.2 billion in structured notes in 2006, although Davila avoided confirming this figure or how much they have since unwound. These illiquid notes are reportedly comprised of Credit Linked Notes (CLNs) based on Argentine, Brazilian, Ecuadorian, and Venezuelan debt (reftel C). The mechanism by which they sought to reduce the country risk premium remains murky to us, though Venezuela's risk rating did fall to below 190 in January. This reduction has been negated by Chavez' actions these past eight months, including nationalizations, threats to leave the IMF, and drops in the country's foreign exchange reserves. As of August 21 Venezuela's risk rating was 477 basis points above treasuries. End Note.)

¶7. (C) He also stated that total "foreign currency assets" of the BRV amount to around USD 65 billion, which inclues foreign exchange reserves, FONDEN, the treasuy account at the BCV, and other opaque BRV and sate-owned firm accounts.

¶8. (C) Despite Chavez'calls for Venezuela to withdraw from the IMF andWorld Bank in April (reftel B), Davila discountedthe likelihood that Venezuela would do so in the nar future. In Davila's words, Venezuela doesn'tintend to "quit school," but rather intends to "e a bad student," with regards to its participation in the Fund and World Bank activities and meetings.

¶9. (C) Davila described BRV concerns about the "speculation" taking place in the parallel foreign currency market. As of August 21, the parallel market was over Bs. 4400/dollar, more than double the official Bs. 2150/dollar rate. Davila claimed that the size of the parallel market was only USD 50 million per week and could easily be controlled by BRV intervention. (Note: Most private sector contacts think it is much larger, as much as USD 200-300 million/week. End Note.) He maintained that the run up in the parallel exchange rate during 2007 has been caused by the elimination of the CANTV ADR transaction, which allowed Venezuelans to obtain dollars by buying local CANTV shares and exchanging them for ADRs sold on the NYSE in the United States. Davila asserted that the replacement of this transparent and open market with the more opaque "permuta" transaction had allowed speculators to bid up the price of dollars. He added that the BRV was working on a plan to create a new market mechanism that would provide more transparency and, according to him, significantly lower the parallel market rate to around Bs. 3100/dollar.

¶10. (C) COMMENT: Davila was appointed to the position in March 2007 and arrived with good reputation. Local contacts and rating agency visitors have described him as competent and effective. He was open with econoffs during the meeting and smoothly painted a positive picture of the BRV's activities. While some of his explanations contradicted conventional wisdom, Davila went to great effort to make the BRV's financial actions seem logical and transparent. As the

BRV's primary representative to visiting investors and rating agencies, he plays the part well. Davila met with econoffs alone and spoke in English. END COMMENT.

BIO NOTE: Davila studied at American University and the University of Pennsylvania and was previously PDVSA's Director of Finance. END NOTE.

FRENCH